



April 21, 2008

AGENDA ITEM 3

TO: MEMBERS OF THE INVESTMENT COMMITTEE

- I. SUBJECT:** Policy Subcommittee Report
- II. PROGRAM:** Total Fund
- III. RECOMMENDATION:**
- a. Real Estate - Revision of the Certification of Responsible Contractor Status Form (Policy on Responsible Contractor Program)
 - b. Global Equity - Revision of Policy on Global Proxy Voting, Consolidation of Global Principles of Accountable Corporate Governance and Core Principles of Accountable Corporate Governance, and Repeal of Existing Principles
 - c. Policy Review and Consolidation Project – Revision of Global Equity Policies:
 - 1) Revision of Policy on Corporate Governance Program
 - 2) Adoption of Policy on Externally Managed Strategies (consolidation of Global Equity externally managed programs) and Related Repeals
 - 3) Revision of Policy on Monitoring Externally Managed Portfolios
 - 4) Repeal of Policy on Passive International Equities – Externally Managed
 - 5) Adoption of Policy on Internally Managed Affiliate Equity Index Funds (consolidation of policies for Standard and Poor's 500 Equity Index Fund Internally Managed Programs) and Related Repeals
 - 6) Revision of Policy on Internally Managed Global Equity Index Funds and Repeal of

- Policy on Dynamic Completion Fund
- 7) Revision of Policy on Internally Managed Global Enhanced Equity Strategies
- 8) Revision of Policy on Risk Managed Absolute Return Strategies Program

IV. ANALYSIS:

Background

The Policy Subcommittee met on March 17, 2008 and elected Henry Jones as Chair and George Diehr as Vice Chair. The Subcommittee also reviewed proposed revisions to Real Estate and Global Equity policies. In addition, the Subcommittee reviewed proposed revisions to Global Equity Policies, as part of the Policy Review and Consolidation Project.

The proposed revised policies are attached. Unless otherwise noted, they are presented as black-lined versions from the last adopted policy by the Investment Committee. The black-line uses strike-out to indicate deletions and double underline to indicate additions. Single underline does not indicate a change; rather, it indicates that the term is defined in the glossary.

- a. Revision of the Certification of Responsible Contractor Status Form (Policy on Responsible Contractor Program)

The Annual Responsible Contractor Report, presented to the Investment Committee in October 2007, included a proposed Responsible Contractor Worksheet ("Worksheet") that would supplement the Certification of Responsible Contractor Status form. Staff asked our partners to "field test" the proposed Worksheet and the results indicate that the Worksheet will be helpful for bidders in accessing their responsible contractor status and for our partners in evaluating potential bidders. Interested labor representatives also commented favorably on the proposed Worksheet. Therefore, the Worksheet has been added to the Responsible Contractor Policy.

The Subcommittee recommends approval of the revised policy.

- b. Revision of Policy on Global Proxy Voting, Consolidation of Global Principles of Accountable Corporate Governance and Core Principles of Accountable Corporate Governance, and Repeal of Existing Principles
 - Global Proxy Voting Policy – Staff recommended policy template improvements and recommended revising references to the Global

and Core Principles of Accountable Corporate Governance, as these two documents have been consolidated (see below).

- Global Principles of Accountable Corporate Governance - Recommended revisions include template formatting and language improvements to support the consolidation of the existing Principles documents. Specific principles have not been deleted; rather, amendments to three existing principles and eleven new principles are being recommended. Attachment 1 describes the three Principle amendments and the eleven proposed Principles.
- As requested by State Controller, John Chiang, the Subcommittee also requested Staff to include additional language, regarding Corporate Board diversity, in Principle 2.4 of the Global Principles of Accountable Corporate Governance document. This change has been made and is reflected in the attached Principles document.

The Subcommittee recommends approval of the revised Global Proxy Voting policy. The Subcommittee also recommends adoption of the consolidated Global Principles of Accountable Corporate Governance, as presented and recommends repeal of the existing Principles.

c. **POLICY REVIEW AND CONSOLIDATION PROJECT – GLOBAL EQUITY POLICIES**

The objectives of the Policy Review Project are (1) to organize and streamline Investment Policy to improve access, clarity and transparency, (2) to provide a consistent Investment Policy framework, and (3) to ensure that the policies will facilitate the on-going CalPERS compliance program.

The Policy Review Project entails a detailed review of each policy with the goal of updating and streamlining the policy, as well as potential consolidation with other related policies. In addition to these goals, the review and revisions include the following:

- Removal of delegations from policy. During the Delegations Project, staff reviewed all policies, minutes, and delegations to identify and consolidate delegations. Delegations are now located in consolidated documents.
- Removal of operational and procedural language, which is now located in staff internal procedure manuals.

- Conformance to the new template.

The review is a joint effort and includes input from the General Pension Consultant, the CalPERS Legal Office, and the Enterprise Office of Compliance.

At the March 17, 2008 meeting, Staff presented the proposed consolidation of and revisions to the Global Equity policies. Clean versions are provided for each policy. Blackline versions of each policy were provided in the March 17, 2008 Policy Subcommittee agenda materials. As a general rule, the revised policies have not been changed substantively. Any substantive changes are explained below.

1) Corporate Governance Program

Language regarding allocation parameters for Corporate Governance (Externally Managed) Funds has been removed because these allocations are established by the Investment Committee and set forth in the Global Equity Sub-Asset Class Allocation Ranges policy.

2) Externally Managed Strategies

This policy consolidates the following externally managed policies: (1) Active Domestic Equities, (2) Active International Equities, (3) Domestic Enhanced Index Strategy, (4) International Enhanced Index Strategy and (5) Relaxed Long-only Domestic Equity Strategy. Specifics on these five programs are included as attachments to the overarching Externally Managed Strategies policy.

No substantive changes were made.

3) Monitoring Externally Managed Portfolios

No substantive changes were made.

4) Passive International Equities – Externally Managed

CalPERS' entire passive international equity portfolio is now managed internally. Therefore, this policy is obsolete and should be repealed.

5) Internally Managed Affiliate Equity Index Funds

This new policy consolidates the Pooled Standard and Poor's 500 Equity Index Fund – Internally Managed and the Deferred Compensation Standard and Poor's 500 Equity Index Fund – Internally Managed Policies. Other changes include:

- Revision of Return Deviation Ranges – To create consistency in the performance expectations, the limitation on fund performance variation for the Pooled Standard & Poor's 500 Index fund was changed from 13 basis points to 20 basis points annually. The 20 basis point performance variation range is consistent with that applied to the Deferred Compensation Standard & Poor's 500 index fund.
- Revision of Reporting Requirements – The original policies discussed, in detail, numerous reports generated for each strategy. This detail has been removed and included in the Staff procedure manuals.

6) Internally Managed Global Equity Index Funds

The Internally Managed Global Equity Index Funds policy incorporates the Dynamic Completion Fund (DCF) policy language. The policy incorporates the Performance Objective and Benchmark for the DCF. Staff also recommended the following changes:

- Removal of the "Watchlist" Language – The Index Funds can be placed on Watchlist Status based on certain criteria, formerly outlined in policy. The criteria has been removed because all Watchlist issues are addressed in the General Pension Consultant's quarterly performance report.
- Removal of "Tracking" Language – The original policies discussed the differences between the calculation methods used in equity benchmark construction and the actual practices used to manage the index investment portfolios. This discussion does not constitute any particular "policy" that relates to the management of the funds. For this reason the section was removed.
- Elimination of Section Dealing with Concentrated Risk - Concentration risk is measured at the entity level, as

opposed to the portfolio level; therefore, this policy provision does not apply to individual portfolio policies and has been removed.

- Revision of Reporting Requirements – The original policies discussed, in detail, numerous reports generated for each strategy. This detail has been removed and included in the Staff procedure manuals.

7) Internally Managed Global Enhanced Equity Strategies

The original policy discussed, in detail, numerous reports generated for each strategy. This detail has been removed and included in the Staff procedure manuals.

8) Risk Managed Absolute Return Strategies Program

The revisions to this policy include the following:

- Refinement of Staff's responsibilities and refinement of the "Absolute Return Strategic Advisor" definition and concept - These refinements clarify each group's roles and allow for flexibility in the particular responsibilities undertaken by each Strategic Advisor.
- Replacement of the term "General Partner" with "Investment Manager" throughout the Policy - This change is to eliminate possible confusion about the type of corporate structure required of firms or professionals managing RMARS portfolio funds.
- Removal of concepts which are more applicable to private-equity funds than absolute-return-funds - For example, Section V(A)(4), which discusses terms to be negotiated, previously included concepts such as "carried interest," "clawback," and "return of capital" which are not terms of common usage in the absolute-return universe.

The Subcommittee recommends approval of the policies listed above. The following Global Equity policies have been recently approved by the Investment Committee. All of these policies conform to the new template format. These policies were not presented for Subcommittee action.

Policy Name	Approval Date
Global Equity Sub-Asset Class Allocation Ranges	September 10, 2007
Emerging Equity Markets Principles	November 13, 2007
Manager Development Program I and II (MDP) Policy and Manager Transition Policy	November 13, 2007

V. STRATEGIC PLAN:

This item supports Goal VIII: Manage the risk and volatility of assets and liabilities to ensure sufficient funds are available, first, to pay benefits and second, to minimize and stabilize contributions.

VI. RESULTS/COSTS:

The results of this item will provide CalPERS with enhanced efficiencies and ability to manage the overall portfolio. The revised policies will provide a foundation for compliance, accountability, and transparency.

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